FILED
U. S.

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1961

No. 524

RAYMOND L. SMITH, INC.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI
to the United States Court of Appeals
for the Ninth Circuit

VALENTINE BROOKES,
PAUL E. ANDERSON,
1720 Mills Tower,
San Francisco 4, California,
Attorneys for Petitioner.

PERKINS-WALSH PRINTING CO., SAN FRANCISCO

Subject Index

	Page
Decision below	1
Jurisdictional statement	2
Questions presented	2
Statutory provisions involved	5
Statement of the case	5
Argument	9
Reasons for allowance for the writ	9
Conclusion	24

Table of Authorities Cited

Cases	Pages
Casey v. Commissioner, 267 F. 2d 26 (C.A. 2, 1959)	11, 16
Cities Service Oil Co. v. Dunlap, 308 U.S. 208 (1939)	17
Helvering v. Chicago Stock Yards Co., 318 U.S. 693 (1943)	19, 21
Helvering v. National Grocery Co., 304 U.S. 282 (1938)	19, 20
Latchis Theatres of Keene, Inc. v. Commissioner, 214 F. 2d 384 (1954)	19
Pelton Steel Casting Co., 28 T.C. 153 (1957), affirmed on other grounds in Pelton Steel Casting Co. v. Commissioner, 251 F. 2d 278 (C.A. 7, 1958), cert. den. 356 U.S. 958	11, 22
R. Gsell & Co., Inc. v. Commissioner, ... F. 2d ..., 61-2 U.S.T.C. 9671 (C.A. 2, Sept. 22, 1961)	11, 12, 14, 16, 17, 20
Raymond I. Smith, Inc., 33 T.C. 141 (1960)	22
Sampson v. Channell, 110 F. 2d 754 (C.A. 1, 1940), cert. den. 310 U.S. 650 (1940)	17

Pages

Singer Mfg. Co. v. Summers, 143 N.C. 102, 55 S.E. 522 (1906) 17

Young Motor Co., 32 T.C. 1336 (1959), reversed in Young Motor Co. v. Commissioner, 281 F. 2d 488 (C.A. 1, 1960) 11, 12, 16, 19, 20, 22

Codes

Internal Revenue Code of 1939:
Section 102 2

Internal Revenue Code of 1954:
Sections 531 et seq. 2
Section 532 23
Section 533 23
Section 534 ..... 3, 8, 9, 21, 23
Section 534(a)(2) 11
Section 535(c) 3, 8, 15

28 United States Code (62 Statutes at Large 928):
Section 1254 2

Rules

Rules of United States Court of Appeals for the Ninth Circuit:
Rule 18(2)(e) 12

Miscellaneous

H. Rep. 1337, 83rd Cong., 2d Sess. (1954), page 52 10

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1961

No.

RAYMOND I. SMITH, INC.,
Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI
to the United States Court of Appeals
for the Ninth Circuit

Raymond I. Smith, Inc. hereby petitions for a writ of certiorari to the United States Court of Appeals for the Ninth Circuit, to review its decision entered June 28, 1961, rehearing of which was denied on August 7, 1961.

DECISION BELOW

The opinion of the Court of Appeals is set forth in the appendix hereto. It is officially reported in 292 F. 2d 470.

It is unofficially reported in 61-2 USTC par. 9562 (C.C.H.) and 8 AFTR 2d 61-5119 (P-H).

The opinion of the Tax Court is set forth in the printed record (R 72-97). It is officially reported in 33 T.C. 141. It is also unofficially reported in CCH Tax Court Reporter as Decision 23,812.

JURISDICTIONAL STATEMENT

The decision below was rendered June 28, 1961 and was entered on the same day. A petition for rehearing was filed on July 19, 1961, and was denied without opinion on August 7, 1961.

Jurisdiction is conferred on this Court to review the decision below by 62 Statutes at Large 928 (United States Code, Title 28, Sec. 1254).

QUESTIONS PRESENTED

A. One group of questions presented involves the proper interpretation and application of provisions added by Congress in 1954 and 1955 to the Internal Revenue Codes of 1939 and 1954, intended to govern trials in the Tax Court of cases involving the penalty tax on accumulated corporate earnings imposed by Section 102 of the 1939 Code and Sections 531 et seq. of the 1954 Code. Briefly, these new provisions reversed "the burden of proof", if certain procedural steps were first taken, and placed it on the Commissioner of Internal Revenue instead of the taxpayer, "with respect to (the) allegation . . . . that all or any part of the earnings and profits

have been permitted to accumulate beyond the reasonable needs of the business".

The questions presented are these:

1. Are these provisions devoid of substantial effect on the basic question of intent, as the Tax Court has consistently held?

2. If the Tax Court is mistaken in this view, as the Court of Appeals held, should the appellate court speculate about what the Tax Court would have held had it understood where the burden of proof lay, or should it remand the case to the Tax Court for reconsideration with proper instructions concerning the burden of proof?

3. Are the questions of purpose of the accumulations and the justification for accumulations mixed questions of fact and law, as the Court of Appeals held, or questions of pure fact, as this Court has held?

B. A second group of questions involves the credit for accumulated earnings, provided for the first time by the 1954 Code. This credit consists of a specific exemption, and of a credit for earnings accumulated for reasonable needs of the business, and exists independently of the decision concerning the intent to minimize shareholder taxes. (Sec. 535(c).) The Commissioner has the burden of proof on the question of the reasonableness of the accumulation. (Sec. 534.)

4. In the computation of the credit for earnings accumulated for reasonable needs of the business can the intention of Congress to shift the burden of proof to the Commissioner be given effect by holding that the Commissioner has sustained his burden of proof where the

record is completely silent on the point which the trial court and the reviewing court both think critical?

5. The same question as that in question 4 is also presented in respect of the basic issue of purpose, where the Court of Appeals held that the Tax Court had incorrectly thought that the burden of proof was on the taxpayer, but the Court of Appeals nevertheless affirmed the Tax Court although the record is completely silent on a point both courts thought critical.

6. Is the intention of the Congress to shift the burden of proof to the Commissioner concerning the reasonableness of the accumulation given effect if the Commissioner can satisfy it by pointing to two circumstances necessarily present in each case of this sort, i.e., the fact that there are accumulated earnings, and the fact that the shareholder's taxes would have been greater than they were had the shareholder's income been increased by dividends from the corporation?

C. A series of questions is also presented about the legitimacy of the standards applied by the Tax Court on the substantive question of purpose.

7. Where a majority of the directors of a corporate taxpayer testify to the reasons which led them to decide against the declaration of dividends, and the Tax Court finds as a fact that the directors did believe that no dividends should be declared for the reasons given, can the Tax Court properly hold that the "purpose" of the corporate taxpayer differed from that of its directors?

8. Can accumulations be held unreasonable because they are insufficient without further accumulations to finance the entire projected program?

9. May the Tax Court properly adopt a standard for measuring the reasonableness of accumulations which required that a taxpayer establish that the profitability of the expansion of its business will be "proper"? This question comprehends both the propriety of the adoption of such a test and the propriety of placing the burden of proof on the taxpayer.

STATUTORY PROVISIONS INVOLVED

The statutes involved are lengthy and accordingly are set forth in the Appendix, infra, pp. i-iv, inclusive.

STATEMENT OF THE CASE

This case arose in the Tax Court by a petition having been filed within 90 days of the date of mailing a deficiency letter. (R. 10, 11.) The Tax Court decided two of the four years before it for petitioner, and an equal number of years for respondent. (R. 98-99.) Petitioner petitioned the Court of Appeals for review of the adverse portions of the decision within three months of the date of decision by the Tax Court. (R. 99, 101, 102.)

Petitioner is a Nevada corporation with its office and place of business in Reno, Nevada. It operates all the bars in Harolds Club, a legal gambling casino in Reno. The two corporations have no shareholders in common, although petitioner's shareholder is general manager of Harolds Club. (R. 73-75.)

Petitioner has no trade name of its own and operates its bars as if they were owned by Harolds Club, even to

using the name "Harolds Club" on the bar glasses and bottles. (R. 79, 91; cf. R. 75.) Petitioner early adopted the policy of using its funds to attract patrons to Harolds Club, that being the only way it could build patronage for itself. Thus petitioner purchased a large collection of old guns and western memorabilia and mounted it in Harolds Club near its bars. (R. 79-81.) This was held by the Tax Court to be a proper use of earnings in petitioner's business, not subjecting it to the penalty tax on accumulating earnings for the purpose of avoiding higher taxes on its shareholder. (R. 89, 91-92.) The Tax Court said of this:

> "The connection between Harolds Club and the petitioner is so close that the use of this material and the outside advertising,[1] all in the name of Harolds Club, also benefits the petitioner in proportion to the benefits received by Harolds Club." (R. 91.)

This policy also led petitioner to buy a motel, refurbish it, and operate it to house out-of-town patrons of Harolds Club. (R. 83-84.) The motel was on land well located for later development as a hotel-casino, but when petitioner sought to acquire neighboring properties in order to accumulate a land area large enough for this purpose it found that identification of the motel with Harolds Club had caused neighboring prices to go out of sight. (R. 84.) The Tax Court found that petitioner's accumulation of earnings in this motel did not subject it to the penalty tax because (R. 92):

---

[1]Here the Tax Court was referring to the employment of one Stagg, former owner of the collection, to travel to fairs and the like and to advertise Harolds Club, all at petitioner's expense. (R. 80-81, 91.)

> "This transaction was closely connected and directly related to the business of the petitioner which in turn was closely tied in with the business of Harolds Club. It enabled the petitioner on behalf of itself and Harolds Club to provide at least some of their patrons with lodging accommodations at reasonable rates and the petitioner with profit and other advantages."

In late 1953 and early 1954 petitioner purchased some 348 acres of farm land near Reno, on the same highway approach to the city as its motel. Having insufficient available funds to pay the entire purchase price, petitioner borrowed much of it. (R. 85.) This land was well suited to use for a resort hotel-casino, similar to those existing near Las Vegas. Both petitioner's and Harolds Club's officers were aware at the time of the purchase that others were trying to buy land in this area for this purpose. (R. 86-87.) In any joint development along these lines, "petitioner was to operate all bars". (R. 87.) When plans were prepared the cost exceeded expectations and available funds and construction has not begun. (R. 87-88.)

The Tax Court held that petitioner was liable for the penalty tax for 1953 and 1954. (R. 97.) It stated: "The purchase of this land at such a large price for the stated purpose by Harolds Club might be one thing, but by the petitioner is quite another." (R. 93.) Although petitioner had duly and timely filed a statement of grounds and supporting facts to explain the accumulation of earnings (R. 26-40), no finding was made about this statement, nor was any reference made to it in the opinion of the Tax Court. The Court of Appeals found the statement suffi-

cient to shift the burden of proof under Sec. 534, 1954 Internal Revenue Code. (Appendix p. xii.) The Tax Court stated:

> "The petitioner, of course, has the ultimate burden of proof." (R. 96.)

The Court of Appeals disagreed. (Appendix, pp. xii-xiii.)

Petitioner claimed, for the year 1954, an accumulated earnings credit equal to its entire net earnings, under Section 535 (c) of the 1954 Code applicable to the 1954 Code. Under Sec. 534 of that Code the burden of proof on that issue was on respondent. The Tax Court said:

> "The petitioner has raised another issue relating to a credit under Section 535 (c)(1) of the Internal Revenue Code of 1954, but the Commissioner has not made any argument with respect to this contention in his briefs." (R. 73.)

Again, the Tax Court said:

> "The Commissioner in his brief ignores this contention . . ." (R. 97.)

The Tax Court sustained the Commissioner, nevertheless.

The Court of Appeals affirmed the Tax Court. Although agreeing with petitioner that the Tax Court had misplaced the burden of proof (Appendix, pp. xii-xiii), the Court of Appeals concluded that no harm had resulted largely because of a finding of the Tax Court, which it regarded as crucial, that the benefits petitioner could hope to derive from the hotel-casino were disproportionate to the size of the investment. (Appendix, pp. xv, xvi.) We contend that the record contains no evidence to support

this finding. The Court of Appeals also stated that the conclusion below was a mixed question of fact and law "and we do not believe that the Tax Court's views as to burden of proof played any part in the determination so made." (Appendix, p. xiv.)

ARGUMENT

REASONS FOR ALLOWANCE FOR THE WRIT

1. This case presents important questions of federal law which have not been, but should be, settled by this Court.

When Congress adopted the monumental 1954 Internal Revenue Code, it attempted to minimize the possibility of injustices occurring in the administration of the penalty tax on accumulated earnings, by reversing the burden of proof on the question of whether earnings have been permitted to accumulate beyond the reasonable needs of the business. Sec. 534. In 1955, Congress again indicated its concern by making this provision applicable to all cases pending in the Tax Court, those arising under the 1939 Code as well as under the 1954 Code. Thus on this issue the Commissioner has the burden of proof irrespective of year involved.

Big business has nothing to fear from this penalty tax, unless it be a closely held big business. Widely held businesses are virtually exempt from it. Since most closely held businesses are small business, this tax singles out small business. Knowledge of this fact, plus its traditional protective concern for the encouragement of small business, led Congress to adopt this measure. The

House Ways and Means Committee, which originated the measure, stated this concern (H. Rep. 1337, 83rd Cong. 2d Sess. (1954), p. 52):

> "Your committee has received numerous complaints that this provision is prejudicial to small business, that it has been applied in an arbitrary manner in many cases, and that it is a constant threat to expanding business enterprises. Fear of the penalty tax is said to result frequently in distribution of funds needed by the corporation for expansion or other valid purposes.
>
> "Your committee believes it is necessary to retain the penalty tax on unreasonable accumulations as a safeguard against tax avoidance. However, several amendments have been adopted to minimize the threat to corporations accumulating funds for legitimate business purposes and to restrict the application of the provision in the case of small companies.
>
> "(1) *Burden of proof.* At the present time if the Commissioner of Internal Revenue proposes a deficiency on the ground that the taxpayer has accumulated earnings and profits in excess of the reasonable needs of the business, the taxpayer has the burden of proof as to the reasonableness of the accumulation . . . .
>
> • • •
>
> "Under your committee's bill, the taxpayer may . . . file a statement of the grounds . . . . If the taxpayer submits such a statement within the proper time, the burden of proof will be upon the Government as to whether the accumulation is in excess of the reasonable needs of the business."

The Tax Court has been unable to give this unusual remedy any substantial effect. It considered this remedy

at length and concluded that it had no substantial effect, in *Pelton Steel Casting Co.*, 28 T.C. 153 (1957), affirmed on other grounds in *Pelton Steel Casting Co. v. Commissioner*, 251 F. 2d 278 (C.A. 7, 1958), cert. den. 356 U.S. 958. It adhered to this position in *Young Motor Co.*, 32 T.C. 1336 (1959), reversed in *Young Motor Co. v. Commissioner*, 281 F. 2d 488 (C.A. 1, 1960). In the present case it did so again, citing and relying on these prior decisions. (R. 96.)

The present case is the most extreme illustration of the Tax Court's failure to give any effect to these amendments of which we have knowledge. The statute imposes a condition precedent to the shift in the burden of proof. This condition is that the taxpayer file with the Commissioner a statement of facts and grounds for the accumulation. Sec. 534(a)(2). The Tax Court thought so little of the significance of the shift in the burden of proof that it did not even make a finding that this condition precedent had been satisfied. The Court of Appeals examined the statement petitioner filed (R. 26-40), and found that the condition precedent had been satisfied (Appendix, p. xii).

At least three Courts of Appeals have disagreed with the Tax Court's view that the shift in the burden of proof is meaningless. *R. Gsell & Co., Inc. v. Commissioner*, ... F. 2d ....., 61-2 U.S.T.C. 9671, (C.A. 2, Sept. 22, 1961); *Casey v. Commissioner*, 267 F. 2d 26 (C.A. 2, 1959); *Young Motor Co. v. Commissioner*, 281 F. 2d 488 (C.A. 1, 1960); and the court below in this case (Appendix, pp. xii-xiii). These appellate court have not agreed among themselves as to what to do about it. In the *Casey* case

and the *Gsell* case, supra, the Tax Court's judgments were reversed; the *Young Motor Co.* case was remanded to the Tax Court for reconsideration in the light of the correct burden of proof; in the present case the Court of Appeals attempted to put itself in the place of the Tax Court and to examine the record in the light of the correct burden of proof. This the court could hardly have been in a position to do completely, since only a portion of the testimony was printed in the record on appeal.[2]

This case illustrates both how the Congressional purpose to provide relief is being frustrated by failure of all courts of appeals to remand to the Tax Court in order that that court will be compelled to try cases in the manner Congress intended, and the probability of injustice if appellate courts do as this one did. First, briefs and arguments on appeal are concerned with points of law, not rearguments of the evidence.[3] Often, as here, much of the evidence will be omitted from the record on appeal. The appellate procedure is therefore not geared to making available to the appellate court the assistance of the attorneys, who often will be familiar with the record from having tried the case, in sifting the evidence. The demands on judges' time make such assistance imperative if they are to do this adequately. Furthermore, the process often does not even bring the entire record before the appellate judges.

---

[2]The appellate court correctly stated that in other cases other courts of appeals have also done what it did (Appendix, p. xiii, footnote 4, citing cases).

[3]The Court of Appeals encourages brevity in briefs by limiting them to 80 pages. Rule 18(2)(e), Rules of United States Court of Appeals for the Ninth Circuit.

Second, this case demonstrates that our concern is justified by the event. Both the Tax Court in its opinion (R. 95) and the Court of Appeals in its opinion (Appendix, p. xvi) regarded as the keystone fact

> "the facts, as in this case, show a gross disproportion between the commitments made and prospective benefits to the taxpayer."

To read that statement, one would suppose the record contained evidence showing what the prospective benefits to the taxpayer were. Yet, startling though it appears to us, there is not a speck of evidence in the record to support the quoted statement, and no one who searches the record for it can honestly claim he has found it.[4] Indeed, what evidence there is tends to point the other way. Thus: from the bars in Harolds Club petitioner earned net income of $224,253.89 and $220,371.08 before taxes, in the two years presently involved (R. 76); it invested $927,976.35 (R. 78) in land to provide a site for a new Harolds Club which petitioner would not have to construct; if it did equally well on the bars in the new club it would earn an annual return of 25%, which would be a very good investment indeed.

Any gap in the record on this point should be held against respondent, who had the burden of proving the unreasonableness of the accumulation. Instead, the Tax Court must have drawn inferences from the gaps in the

---

[4]We pointed this out to the appellate court once in our brief. Respondent did not reply to our statement. No reference to it was made in the oral argument, which was concerned with points of law. The appellate court evidently overlooked our statement on brief and respondent's failure to reply.

record adverse to the party it thought had the burder (petitioner), and the appellate court seized on the Tax Court's unsupported statement to conclude that no prejudice to us occurred from the Tax Court's erroneous view about location of the burden of proof. This case thus illustrates the dangers in an appellate court's attempting to review the record to guess how the Tax Court would have decided the case had it understood where the burden of proof lay, and represents an excellent vehicle for this Court's study of the problem and administration of appropriate corrective measures.

The importance of the problem is evident from both the attention it twice received from Congress and from the number of cases which have arisen which present it in one form or another. Congress not only adopted legislation shifting the burden of proof in 1954, but thought enough of the problem to work on it again in 1955, when it extended the new provision to cases arising under the 1939 Code. There are numerous cases presenting the problem, as is evident from the fact that the briefs in the lower court referred to 11 such cases in the appellate courts alone, decided in the last four years. The present case is the twelfth. *R. Gsell & Co., Inc. v. Commissioner*, ... F. 2d ..... (C.A. 2, Sept. 22, 1961), cited above, is another later case.

The numerous appellate court cases do not, unfortunately, advance us far toward clarification of the problem. Although the Tax Court has been affirmed where it has expressed the views it did here, those affirmances have been on the ground that the evidence as a whole supported the decision regardless of where the burden

of proof lay,[5] and none of them to our knowledge has agreed with the Tax Court's emasculation of the 1954 and 1955 legislation. Yet the Tax Court has not admitted the error of its ways and given effect to the Congressional enactments.

Moreover, there is a substantive aspect to the problem under the 1954 Code, present in the instant case, which should be presented in increasing number. This case was the first one in which the Tax Court considered the new credit for reasonably accumulated earnings adopted in the 1954 Code as Section 535(c). The point of this amendment is that even a taxpayer found to have accumulated earnings for the purpose of reducing its shareholders' taxes is entitled to have the taxable corpus reduced by "such part of the earnings and profits for the taxable year as are retained for the reasonable needs of the business". In the determination of this credit, the Commissioner has the burden of proof. The Tax Court was thoroughly bewildered by this point. It referred twice (R. 73, 97) to the fact that the Commissioner ignored this issue, but held, in effect, that taxpayer's failure to demonstrate a proper relation between the amount of the investment and the anticipated return was sufficient to carry the Commissioner's burden of proof. This is palpably wrong, but the appellate court failed to correct the error because it assumed erroneously that the Tax Court's statement that there was not a proper relation between amount of investment and anticipated return rested on some evidence in the record.

---

[5]As we have demonstrated, this case, where there was no evidence on a point both lower courts thought crucial, illustrates the inadequacy of the appellate process to retry questions of fact.

The first taxable year in which this particular issue can arise is 1954, which explains why this case is the first one to present it. There are certain to be many more.

Accordingly, the problem cannot be expected to simply go away. It will remain until corrected by this Court.

2. The Court of Appeals sanctioned an improper procedure, the effect of which is to nullify a federal statute. Congress intended the shift in the burden of proof to have both meaning and significance. The Court of Appeals held, as have at least two other courts of appeals,[6] that the Tax Court deprived it of real meaning and of all its significance, by trying the case as if the burden of proof had never been shifted to respondent. Contrary to correct procedure, however, the appellate court did not remand the case to the Tax Court with instructions to reassess the case in the light of the correct burden of proof. Instead the Court of Appeals attempted to reassess the case itself.

In failing to remand the case to the Tax Court to reconsider the case and in so doing to apply the burden of proof to the party on whom Congress intended it to fall, the Court of Appeals has sanctioned a nullification of the Congressional enactment. Here was the unusual situation of the party on whom the burden was placed actually standing mute as to one of the issues, that arising in the taxable year 1954 for the first time, yet prevailing.

---

[6]That for the first circuit in *Young Motor Co. v. Commissioner*, 281 F. 2d 488 (C.A. 1, 1960), and that for the second circuit in *Casey v. Commissioner*, 267 F. 2d 26 (C.A. 2, 1959), and *R. Gsell & Co., Inc. v. Commissioner*, ... F. 2d ....., 61-2 U.S.T.C. 9671, (C.A. 2, Sept. 22, 1961).

Moreover, respondent offered no evidence tending to establish what return petitioner could expect from the bars in the hotel when completed, yet both the Tax Court (R. 95) and the Court of Appeals (Appendix, pp. xv, xvi) considered the finding of the former court on this point to be essential to the Tax Court's decision; as indeed it was. Yet the finding was wholly without evidence to support it, and must have been a negative inference from the silence of the record, properly drawn only if the petitioner had the burden of proof.

If cases can be tried and decided this way, the shift in the burden of proof is to no avail, and the statute is nullified. This Court should review the case to declare how the statute may be given effect.

3. The Court of Appeals was itself guilty of a departure from proper procedure, which should not be permitted by this Court.

Normal procedure where the burden of proof is misapplied during a trial is to remand to the trial court for reconsideration or, if the case was tried to a jury, for a new trial. *Cities Service Oil Co. v. Dunlap*, 308 U.S. 208 (1939); *Sampson v. Channell*, 110 F. 2d 754 (C.A. 1, 1940), cert. den. 310 U.S. 650 (1940); *Singer Mfg. Co. v. Summers*, 143 N.C. 102, 55 S.E. 522 (1906). The Court of Appeals departed from this salutary rule, and attempted to review the record to determine whether the Tax Court might decide differently on remand. This procedure, in reviewing a pure question of fact, was improper unless, as the Court of Appeals for the Second Circuit recently expressed it,[7] the evidence is convincing

[7] *R. Gsell & Co., Inc. v. Commissioner*, __ F. 2d __, (C.A. 2, Sept. 22, 1961), supra.

that there is no possible justification in the taxpayer's business for the accumulation.

Since there was no evidence at all on what both lower courts regarded as the key point in assessing the reasonableness of the accumulation, it is apparent that there was not convincing evidence.

The Court of Appeals left no doubt either of the importance it attached to this point, or of its assumption that evidence existed to support the Tax Court's statement of fact. The Court of Appeals said:

> "In its opinion the (Tax) Court reasoned that while any benefits received by Harold's Club also benefit petitioner, an expenditure by the latter for the benefit of Harold's Club *could be so out of proportion* to petitioner's capitalization, income and position as an adjunct business that it would be unreasonable for purposes of the petitioner's business as Congress used those words in section 533." (Appendix, pp. xiv, xv.) (Emphasis ours.)

Again:

> "Congress did not want the taxing authorities to be second-guessing the responsible managers of corporations as to whether and to what extent profits should be distributed or retained, unless they were in a position to prove that their position was correct. Casey v. C.I.R., 2 Cir., 267 F. 2d 26, 30. They are in that position, we believe, *when the facts, as in this case, show a gross disproportion between the commitments made and prospective benefits to the taxpayer.*" (Appendix, p. xvi.) (Emphasis ours.)

Plainly the Court of Appeals thought that there were the facts which it stated existed, yet they do not exist.

Neither evidence nor stipulation of facts shows what income petitioner could expect from the bars in the hotel, and unless the expected income were known its proportion to something else must remain a mystery.

The error the Court of Appeals made illustrates the probability of error inherent in permitting the Tax Court to try cases with the burden of proof in the wrong place. This Court should not permit the Court of Appeals to let the error go uncorrected but should review this case as a clear vehicle for illustrating the dangers in departure from correct procedure.

4. The decision below, in holding that the issue in these cases is a mixed question of fact and law (Appendix, p. xiv), conflicts with decisions of another court of appeals, and with two decisions of this Court.

The Court of Appeals agreed, as have others before it, that the Tax Court had erred in its view that the burden of proof was on petitioner (Appendix, pp. xii-xiii). It said, however, that it had a mixed question of fact and law before it, on which it had the right to pass (Appendix, p. xiv). In so holding, the Court of Appeals proceeded contrary to the decisions of this Court in *Helvering v. Chicago Stock Yards Co.*, 318 U.S. 693 (1943), and in *Helvering v. National Grocery Co.*, 304 U.S. 282 (1938). Also, its decision on this point is contrary to the views of the Court of Appeals for the First Circuit in *Latchis Theatres of Keene, Inc. v. Commissioner*, 214 F. 2d 384 (1954), and *Young Motor Co. v. Commissioner*, 281 F. 2d 488 (1960).

In addition to the conflict on this important point with decisions of this Court and of another court of appeals,

the decision below is in conflict with the logical implications of the statute itself. Obviously, Congress accepted and made no effort to change the view of this Court that the question of unreasonable accumulation was one of fact, for it merely shifted the "burden of proof", a concept pertaining to proof of fact, not persuasion of law.

5. The Tax Court in this case, as in others, found factual support for its decision against petitioner in the circumstances that the corporate income was accumulated instead of distributed, and the shareholder's tax would have been greater had dividends been declared (R. 96). The Court of Appeals agreed that these circumstances were correctly taken into account (Appendix, p. xvii).

The Court of Appeals for the First Circuit, in *Young Motor Co. v. Commissioner,* 281 F. 2d 488, 491, and the Court of Appeals for the Second Circuit, in *R. Gsell & Co., Inc. v. Commissioner,* ..... F. 2d ....., 61-2 U.S.T.C. 9671, both held, reversing the Tax Court, that these circumstances were present in every case where these actions might apply and were neutral, not probative. There is, therefore, a conflict about the effect of these facts between these two circuits and the court below unless there are other facts here to support the Tax Court.

In the paragraph of its opinion where these circumstances and those necessarily implicit in them were recounted, the Tax Court also referred to the facts that petitioner paid no salary to its shareholder (nor did it to any of its officers), and that he had transferred income producing property to it (R. 96). The Tax Court cannot have meant to hold the latter circumstance against petitioner, however, for the transfer was at the time of

petitioner's incorporation (R. 75-76), had a business motivation (R. 75), and no contention was ever made that petitioner was formed to avoid the surtax on its shareholder (R. 90). Moreover, both circumstances were present with respect to the taxable years 1950 and 1952, in which the Tax Court decided favorably to petitioner. These facts cannot logically be compelling in only some of the years.

Accordingly, the Tax Court must have given controlling weight to the circumstances that more taxes would have been paid by its shareholder had petitioner paid dividends, and in affirming the Tax Court the court below rendered a decision in conflict with those of two other courts of appeals.

6. Administration of the law in this area would be aided by clarification by this Court of the meaning of its prior decisions. The reason the Tax Court has had such difficulty in giving effect to these recent statutes is that it considers that they relate only to a subsidiary issue, not to the principal issue. The Tax Court has this difficulty because of the way in which it interprets two decisions of this Court: *Helvering v. Chicago Stock Yards Co.*, 318 U.S. 693 (1943), and *Helvering v. National Grocery Co.*, 304 U.S. 282 (1938). This Court is the only tribunal with authority to dispel finally the confusion the Tax Court finds between those decisions and effective implementation of the 1954-1955 amendments, so it should review this case for this purpose.

The shift of the burden of proof is on the issue whether the accumulation is within the reasonable needs of the business (Section 534). As the Tax Court interprets the

decisions of this Court cited above, that issue merely creates a presumption against the taxpayer if decided against him and has no significance if decided for him. *Pelton Steel Casting Co.*, 28 T.C. 153 (1957), affirmed on other grounds 251 F. 2d 278 (C.A. 7, 1958), cert. den. 356 U.S. 958; *Young Motor Co.*, 32 T.C. 1336 (1959), reversed 281 F. 2d 488 (C.A. 1, 1960); *Raymond I. Smith, Inc.*, 33 T.C. 141 (1960), disapproved on this point but affirmed in this case below. The result is that in this case the amendments were ignored even to the extent that the required procedural finding was not made.

This Court has not considered the effect the 1954-1955 amendments have, as they were enacted years after the decisions referred to were rendered. We believe that ultimately this Court must consider and decide what effect these amendments have in the light of its earlier decisions. The instant case is a strikingly appropriate vehicle.

7. If certiorari is granted, the Court may desire to consider certain provocative aspects of this case either entirely or partly substantive in nature.

a. The Tax Court found as a fact that two of the three members of petitioner's board of directors considered that "no dividend should be paid . . . because of the obligations then existing, including the obligation on the purchase price of the land . . ." (R. 89). Since the directors made petitioner's decisions for it, this finding amounts to a finding explaining why petitioner did not pay dividends. Yet the Tax Court held, inconsistently with this finding (R. 97), that petitioner paid no dividends because of a purpose to avoid the surtax on its shareholders.

This Court may wish to consider whether the Tax Court can ignore admittedly truthful testimony explaining the failure to pay dividends in deciding why dividends were not paid.

b. Petitioner actually acquired the land in question, going deeply into debt to do so. Accordingly, as the Tax Court acknowledged (R. 91), this case involves an actual acquisition, not mere reserves for planned future acquisitions. Petitioner and Harolds Club, the Tax Court also found (R. 87-88), "realized that the development of the farm land could not be started until they could accumulate additional earnings in view of the $17,000,000 estimate, the fact that a part of the purchase price of the land had not been paid, (etc.)." Yet the Tax Court appears to have considered the failure of petitioner and Harolds Club to begin construction of the hotel-casino by trial time as some evidence of the interdicted purpose (R. 94-96).

This Court may wish to consider whether insufficiency of accumulations on hand to accomplish the corporate purpose without further accumulations makes the accumulation of the inadequate funds improper and taxable.

c. The Tax Court appears to have assumed the authority to impose this penalty tax if it considers that a business investment is not going to be as profitable as the Tax Court considers proper (R. 95-96), and the Court of Appeals has approved what the Tax Court has done (Appendix, p. xvi).

This Court may wish to consider whether the Tax Court may, under the guise of determining the "purpose" (Sections 532, 533, 534) on which the imposition of the

penalty tax depends, create standards of proper profitability.

CONCLUSION

The writ of certiorari should issue.

Dated, San Francisco, California,
October 25, 1961.

Respectfully submitted,

VALENTINE BROOKES,
PAUL E. ANDERSON,
Attorneys for Petitioner.

(Appendix Follows.)

Appendix

Sec. 531. Imposition of Accumulated Earnings Tax.

In addition to other taxes imposed by this chapter, there is hereby imposed for each taxable year on the accumulated taxable income (as defined in section 535) of every corporation described in section 532, an accumulated earnings tax equal to the sum of—

(1) 27½ percent of the accumulated taxable income not in excess of $100,000, plus

(2) 38½ percent of the accumulated taxable income in excess of $100,000.

Sec. 532. Corporations Subject to Accumulated Earnings Tax.

(a) General Rule.—The accumulated earnings tax imposed by section 531 shall apply to every corporation (other than those described in subsection (b)) formed or availed of for the purpose of avoiding the income tax with respect to its shareholders or the shareholders of any other corporation, by permitting earnings and profits to accumulate instead of being divided or distributed.

(b) Exceptions.—The accumulated earnings tax imposed by section 531 shall not apply to—

(1) a personal holding company (as defined in section 542),

(2) a foreign personal holding company (as defined in section 552), or

(3) a corporation exempt from tax under subchapter F (section 501 and following).

Sec. 533. Evidence of Purpose to Avoid Income Tax.

(a) UNREASONABLE ACCUMULATION DETERMINATIVE OF PURPOSE.—For purposes of section 532, the fact that the earnings and profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid the income tax with respect to shareholders, unless the corporation by the preponderance of the evidence shall prove to the contrary.

Sec. 534. Burden of Proof.

(a) GENERAL RULE.—In any proceeding before the Tax Court involving a notice of deficiency based in whole or in part on the allegation that all or any part of the earnings and profits have been permitted to accumulate beyond the reasonable needs of the business, the burden of proof with respect to such allegation shall—

(1) if notification has not been sent in accordance with subsection (b), be on the Secretary or his delegate, or

(2) if the taxpayer has submitted the statement described in subsection (c), be on the Secretary or his delegate with respect to the grounds set forth in such statement in accordance with the provisions of such subsection.

(b) NOTIFICATION BY SECRETARY.—Before mailing the notice of deficiency referred to in subsection (a), the Secretary or his delegate may send by certified mail or registered mail a notification informing the taxpayer that the proposed notice of deficiency includes an amount with respect to the accumulated earnings tax imposed by sec-

tion 531. In the case of a notice of deficiency to which subsection (e)(2) applies and which is mailed on or before the 30th day after the date of the enactment of this sentence, the notification referred to in the preceding sentence may be mailed at any time on or before such 30th day.

(c) STATEMENT BY TAXPAYER.—Within such time (but not less than 30 days) after the mailing of the notification described in subsection (b) as the Secretary or his delegate may prescribe by regulations, the taxpayer may submit a statement of the grounds (together with facts sufficient to show the basis thereof) on which the taxpayer relies to establish that all or any part of the earnings and profits have not been permitted to accumulate beyond the reasonable needs of the business.

(e) APPLICATION OF SECTION.—

(1) Notwithstanding any other provision of law, this section shall apply with respect to taxable years to which this subchapter applies and (except as provided in paragraph (2)) to taxable years to which the corresponding provisions of prior revenue laws apply.

(2) In the case of a notice of deficiency for a taxable year to which this subchapter does not apply, this section shall apply only in the case of proceedings tried on the merits after the date of the enactment of this paragraph.

Sec. 535. Accumulated Taxable Income.

(a) DEFINITION.—For purposes of this subtitle, the term "accumulated taxable income" means the taxable income, adjusted in the manner provided in subsection (b),

minus the sum of the dividends paid deduction (as defined in section 561) and the accumulated earnings credit (as defined in subsection (c)).

(c) ACCUMULATED EARNINGS CREDIT.—

(1) GENERAL RULE.—For purposes of subsection (a), in the case of a corporation other than a mere holding or investment company, the accumulated earnings credit is (A) an amount equal to such part of the earnings and profits for the taxable year as are retained for the reasonable needs of the business, minus (B) the deduction allowed by subsection (b) (6). For purposes of this paragraph, the amount of the earnings and profits for the taxable year which are retained is the amount by which the earnings and profits for the taxable year exceed the dividends paid deduction (as defined in section 561) for such year.

(2) MINIMUM CREDIT.—The credit allowable under paragraph (1) shall in no case be less than the amount by which $100,000 exceeds the accumulated earnings and profits of the corporation at the close of the preceding taxable year.

Sec. 537. Reasonable Needs of the Business.

For purposes of this part, the term "reasonable needs of the business" includes the reasonably anticipated needs of the business.

United States Court of Appeals
for the Ninth Circuit

Raymond I. Smith, Inc., Petitioner, vs. Commissioner of Internal Revenue, Respondent.	No. 17,015 June 28, 1961

Petition to Review a Decision of the Tax Court
of the United States

Before: Pope, Hamley and Koelsch, Circuit Judges

Hamley, Circuit Judge:

The Commissioner of Internal Revenue gave Raymond I. Smith, Inc., notice of his determination that there were deficiencies in the taxpayer's income and excess profits taxes for the years 1950, 1952, 1953 and 1954. The company petitioned the Tax Court for a redetermination of the deficiencies. Prior to trial the parties settled by stipulation all claimed deficiencies except those for accumulated earnings taxes asserted under section 102(a) of the Internal Revenue Code of 1939, ch. 289, § 102, 52 Stat. 483, and section 531 of the Internal Revenue Code of 1954, 26 U.S.C.A. § 531.

The Tax Court held that no deficiencies were due from the company under section 102 for the years 1950 and 1952. That court held, however, that in 1953 there was a

deficiency in the amount of $25,365.33 under former section 102, and that in 1954 there was a deficiency in the amount of $31,461.36 under section 531. Raymond I. Smith, Inc., has petitioned to review this adverse decision as to the 1953 and 1954 taxes.

An accumulated earnings tax may not be imposed unless a corporation has been formed or availed of for the purpose of avoiding the income tax with respect to shareholders by permitting earnings or profits to accumulate instead of being divided or distributed.[1] The Tax Court sustained the Commissioner's determination that petitioner corporation had been used for this purpose in 1953 and 1954.

Petitioner argues here that in reaching this decision the Tax Court erroneously placed the burden of proof upon petitioner, disregarded its own findings of fact which should have led to a contrary decision, and erroneously failed to allow petitioner an accumulated earnings credit for 1954.

Petitioner is a Nevada corporation having as its principal business the operation of the bars in Harold's Club, in Reno, Nevada. Harold's Club, occupying several adjoining buildings in downtown Reno, operates a legalized gambling casino. Harold S. and Raymond A. Smith operated the club as a partnership from June 1, 1938, to December 31, 1946, at which time Harold's Club was incorporated.

---

[1]See section 532 of the Internal Revenue Code of 1954, 26 U.S.C.A. § 532. Substantially the same test was set out in section 102(a) of the 1939 revenue act.

Their father, Raymond I. Smith, was employed as general manager of the club but owned no interest therein. During all of the time here concerned his compensation as manager was $10,000 a year plus twenty per cent of the net profits before income taxes and officers' compensation. This amount ranged from about $44,000 in 1941 to a high of $557,559.57 in 1953.

No liquor was sold on the premises prior to 1943. In that year the sons, although they refused to participate in any bar operation, permitted their father to install bars and operate them on his own account while continuing as general manager of the club. It was the father's view that the casino operation would be benefited if patrons could obtain liquor on the premises instead of having to go elsewhere.

Raymond I. Smith operated the bars as a sole proprietor until the end of 1946. During the years 1944 to 1946 the net income realized therefrom averaged about $73,000 a year. In computing his income taxes, Smith allocated this net income between himself and his wife and valued his services in operating the bars at $10,000 a year. Smith incorporated the bar operation on November 15, 1946, and is the sole stockholder of Raymond I. Smith, Inc.

Since its incorporation this company has earned and paid income taxes on net income ranging from a low of $100,209.24 in 1948 to a high of $278,630.70 in 1955. It has, however, paid no salary or dividends to Raymond I. Smith during any of these years. As a result, by 1955 the corporation had accumulated undistributed earnings in the sum of $781,475.25. During the years 1950 through

1954, Smith and his wife reported and paid federal income taxes on income (representing primarily his compensation as manager of Harold's Club) ranging from a low of $83,040.48 in 1952 to a high of $247,719.46 in 1950. Their tax brackets for those years ranged from 80% in 1952 to 90% in 1950.

Petitioner draws its entire clientele from the patrons of Harold's Club. Petitioner's business promotion was therefore designed to increase club patronage and to protect the club from competition; the bars were not advertised as a separate business. Such promotion further benefited Raymond I. Smith in that his compensation as general manager of the club was geared to the club's net income.

One promotion outlay was for the purchase and display of the so-called Roaring Camp collection of memorabilia of the Old West. Petitioner purchased this in 1949 for $150,000, and the former owners of the collection were employed at substantial expense to transport it to fairs, rodeos and other gatherings for the purpose of advertising Harold's Club.

Another such expenditure was for the purchase on December 31, 1951, of the Moana Auto Apartments for a price of $200,000. This was a motel on the southern outskirts of Reno near the airport and on the main road from Reno to Los Angeles. The Moana provided accommodations available to patrons of Harold's Club, which operated limousine service between the motel and the club. In September 1953 petitioner purchased the land and buildings of the Moana Coffee Shop for a price of $25,233.30. This restaurant was needed to complement

the hotel facility, and petitioner also planned to install a bar as soon as the then existing lease expired.

The Moana Motel and Coffee Shop did not, however, prove attractive to club patrons, and their operation by petitioner was creating ill will with other motel operators who were in a position to help or hurt Harold's Club. For these reasons the Moana facilities were sold in 1955.

In December 1953 petitioner purchased two parcels of land approximately three miles south of Reno on the main highway from Las Vegas, Carson City and the south end of Lake Tahoe. The purchase price of one parcel consisting of 339 acres of farm land was $818,842.75. The second parcel was 6.186 acres adjacent to the first, having a 520-foot highway frontage, which petitioner purchased for $52,036.80. An additional 2½ acres of adjoining land representing a strip of highway frontage 936 feet long was purchased by petitioner in 1954 for $110,096.80. Petitioner borrowed $500,000 in 1953 from Harold's Club on its demand note to pay on the purchase price of the 339-acre tract. A $400,000 payment was made on this note in 1954.

The farm property was originally offered to Harold's Club but the club was not in a position to make the purchase because of prior commitments, including the construction of a seven-story building at its downtown Reno location. It was able to lend $500,000 to the petitioner on a short term basis because it would not need that part of its accumulations for the erection of its new building until contruction progressed.

When petitioner made these farm-land purchases, its officers and those of Harold's Club were aware that other

persons were trying to buy property near Reno for so-called "strip operation" purposes. A strip operation may include a hotel, motel, or both, a gambling casino, and possibly other related operations on a strip of land fronting on a main highway. The owners of Harold's Club and the petitioner felt that Harold's Club had to be protected against competition of this kind, and desirable land might not be available later. Harold's Club had purchased 180 acres for $120,000 in 1951 with this in mind. The latter property, however, was located about seven miles west of Reno and was not regarded as particularly favorable for a strip operation.

At the time of purchasing this farm land petitioner had no plans for its immediate development. Petitioner and Harold's Club planned to develop the property later if necessary. The plan for later development contemplated a large hotel, gambling casino, convention hall, all-season swimming pool, golf course and some residential property surrounding the golf course, all at an anticipated cost of $10,000,000.

Petitioner employed architects who presented preliminary drawings in 1957 together with an estimate of $17,000,000 as the probable cost. Petitioner and Harold's Club realized that in view of this high estimate the contemplated development could not be started until they had accumulated additional earnings. No blueprints have been prepared, and the property has been leased to crop farmers. Petitioner recorded a net loss of $21,158.65 on the property for 1954.

Harold I. Smith, who was president and treasurer of petitioner, and Guy Lent, the petitioner's secretary, con-

sulted each year with petitioner's certified public accountant concerning the payment of dividends. Each year the accountant advised that no dividend should be paid because the petitioner was not in a financial position to do so. Lent made similar recommendations to Smith, principally on the basis of petitioner's commitments in connection with the various purchases which have been described.

The facts summarized above are consistent with the Tax Court's formal findings of fact, and are not challenged on this review. In the section of its report denominated "Opinion" the Tax Court concluded that petitioner was availed of for the purpose of avoiding income taxes for 1953 and 1954 with respect to its sole shareholder, Raymond I. Smith.

On this review petitioner argues at length that whereas the burden of proof to establish the proscribed purpose rightfully was on the Commissioner, the Tax Court placed that burden upon petitioner and held against petitioner on the ground that it had not sustained that burden.

The Commissioner based his determination that petitioner had the proscribed purpose on the ground that the accumulations in question were beyond the reasonable needs of the business.[2] This is at least a permissible premise (petitioner seems to argue that under the circum-

---

[2]This ground is not disclosed in the notice of deficiencies. In respondent's answer to the taxpayer's petition to the Tax Court, however, respondent states, "In support of respondent's determination that during the taxable years 1950, 1952, 1953 and 1954 the petitioner was availed of for the purpose of preventing the imposition of the surtax [income tax] upon its sole stockholder, through the medium of permitting earnings and profits to accumulate instead of being divided or distributed, respondent alleges

stances of this case it is the only premise) from which it may be inferred that there was such a purpose. As did section 102(c) of the 1939 Code, section 533(a) of the Internal Revenue Code of 1954, 26 U.S.C.A. § 533(a), provides that if the earnings and profits of a corporation are permitted to accumulate beyond the reasonable needs of the business, that fact shall be determinative of the purpose to avoid the income tax with respect to shareholders unless the corporation by the preponderance of the evidence shall prove to the contrary.

But where, as here, the taxpayer has submitted a statement of the grounds relied upon to establish that the accumulations were for the reasonable needs of the business the burden of proving that such accumulations were beyond the reasonable needs of the business is on the Commissioner with respect to the grounds set forth in the taxpayer's statement. Section 534(a) of the Internal Revenue Code of 1954, 26 U.S.C.A. § 534(a).[3] The grounds set forth in the taxpayer's statement are the same as those upon which it has relied in the Tax Court and on this review.

---

that in each of said years the petitioner distributed none of its earnings and that the entire accumulation of petitioner's earnings in each of said years was beyond the reasonable needs of the business." We may therefore assume that this was the ground relied upon in making the initial determination.

[3]There was no similar provision in the 1939 Code. By an amendment of section 534 enacted in 1955, however, the burden of proof rule set out in section 534(a) was made applicable to taxable years to which the corresponding provisions of prior revenue laws apply, provided the proceedings on the merits were had after the date of the 1955 enactment. The 1955 amendment of section 534 was enacted on August 11, 1955, 69 Stat. 690, 691. The proceedings on the merits herein were had in the Tax Court in June 1959. The burden of proof rule set out in section 534 as amended is therefore applicable with regard to both the 1953 and 1954 taxes here in question.

The Tax Court's opinion states, "The petitioner, of course, has the ultimate burden of proof." As indicated above, this is not true in any case covered by section 534 if by "ultimate burden of proof" the Tax Court was referring to the burden of proving that the accumulations were beyond the reasonable needs of the business. Moreover, it is not true in this case if the Tax Court was referring to the burden of proving the proscribed purpose, to avoid the income tax upon shareholders. The Commissioner sought to prove that purpose only by showing that accumulations were excessive, and as to this showing the Commissioner had the burden of proof.

The Tax Court's statement is correct if it was referring to the burden of proof placed upon a taxpayer where the Commissioner has established the basic fact that the accumulations were excessive. As stated in section 533(a), that fact is determinative of the proscribed purpose "unless the corporation by the preponderance of the evidence shall prove to the contrary."

But if we should assume that the Tax Court incorrectly determined that the burden of proof here rested with the taxpayer, no prejudice would have resulted unless a finding of fact adverse to petitioner was predicated only on petitioner's failure to sustain the burden of proof.[1] We have examined the record and can find no substantial

---

[1]On similar reasoning other courts have usually declined to discuss the burden of proof question and have proceeded at once to the underlying problem of whether the findings are supportable on the basis of affirmative evidence in the record. American Metal Corp. v. Commissioner, 8 Cir., 287 F.2d 860, 861-62; Dixie, Inc. v. Commissioner, 2 Cir., 277 F.2d 526, 527; Smoot Sand & Gravel Corp. v. Commissioner, 4 Cir., 274 F.2d 495, 504; I. A. Dress Co. v. Commissioner, 2 Cir., 273 F.2d 543, 544.

finding which falls in this category. Almost all the facts were agreed to prior to trial, and none of those recited in the formal findings are challenged.

Only the ultimate finding and conclusion set out in the Tax Court's opinion, that petitioner accumulated excessive earnings and therefore had the proscribed purpose, are questioned. These, however, represent the resolution of mixed questions of fact and law on the basis of the probative evidence in the record, and we do not believe that the Tax Court's views as to burden of proof played any part in the determination so made.

We conclude that petitioner has not been prejudiced by the views entertained by the Tax Court as to the burden of proof in this case, whatever those views may have been.

Petitioner next argues that the decision of the Tax Court is not supported by its findings. It is contended specifically that the recitals in the opinion are in conflict with the formal findings of fact and also indicate skepticism concerning some of the facts set out in the findings.

In its opinion the Tax Court stated that the purchase of the farm land "at such a large price for the stated purpose by Harold's Club might be one thing, but by the petitioner is quite another." Petitioner believes that this conclusion is inconsistent with the court's finding that "whatever is done for one corporation also benefits the other."

We do not believe that the two statements are inconsistent. The quoted finding refers to the fact that services rendered by Lent to Harold's Club also benefited petitioner. In its opinion the court reasoned that while any

benefits received by Harold's Club also benefit petitioner, an expenditure by the latter for the benefit of Harold's Club could be so out of proportion to petitioner's capitalization, income and position as an adjunct business that it would be unreasonable for purposes of the petitioner's business as Congress used those words in section 533.

There are instances in the opinion in which skepticism is expressed concerning some of the findings of fact. But the findings on which the Tax Court relied in concluding that petitioner both had unreasonably accumulated earnings and that the accumulation was for the proscribed purpose are set forth in the opinion. These were the facts that petitioner was an adjunct business with a stake in the prosperity of Harold's Club which while direct was relatively minor as compared to that of the Club; that petitioner's assets and annual income were relatively modest in relation to the commitments it undertook in acquiring the farm lands; that the prospect of petitioner's ever making use of the farm lands was questionable and in any event remote and vague.

It was on the basis of these facts that the Tax Court reached the conclusion that the accumulations exceeded the reasonable needs of the business. That conclusion is stated expressly with regard to 1954, and for 1953 is necessarily to be implied from the opinion read as a whole. If the law permits such a conclusion to be drawn from such facts (see discussion below), the proscribed purpose was established prima facie.

The expressions of doubt in the Tax Court's opinion concerning the adopted findings regarding the purpose of the accumulations and the recital therein of other facts

tending to show a purpose to avoid taxes[5] do not render any less supportable its basic conclusion that the reasonable needs of the business were exceeded. At most they represent the statement of an alternative ground for the Tax Court's conclusion that petitioner had the proscribed purpose. If the primary ground relied upon was adequate, the Tax Court's warrant to state the alternative ground is immaterial.

The real question posed by the Tax Court's decision is not whether the conclusions concerning the reasonable need for the accumulation are supported by the findings, but whether they evidence an erroneous understanding of section 533, in which the accumulation "beyond the reasonable needs of the business" test is prescribed.

In our view they do not. Congress did not want the taxing authorities to be second-guessing the responsible managers of corporations as to whether and to what extent profits should be distributed or retained, unless they were in a position to prove that their position was correct. Casey v. C.I.R., 2 Cir., 267 F.2d 26, 30. They are in that position, we believe, when the facts, as in this case, show a gross disproportion between the commitments made and prospective benefits to the taxpayer.

---

[5]In its opinion the Tax Court stated that Smith's taxable income during each of the taxable years was large and placed him in high tax brackets, that he owned and controlled the petitioner, that the petitioner paid no dividends and paid Smith no salary, that income producing property was assigned to the petitioner corporation by Smith, and that the retention by the petitioner of its earnings would save Smith from surtaxes which he would have had to pay if the petitioner had distributed dividends to him.

We hold that the conclusions stated in the opinion of the Tax Court are supported by the findings of fact and give correct application to the governing statutes.

Petitioner argues that in any event the Tax Court erred in failing to allow it an "accumulated earnings credit" for 1954. The reference here is to section 535(c) of the Internal Revenue Code of 1954, 26 U.S.C.A. § 535(c), which, as petitioner concedes, is not applicable to the year 1953.

This credit is to be an amount equal to such part of the earnings and profits for the taxable year "as are retained for the reasonable needs of the business." For the purpose of determining such credit, the term "reasonable needs of the business" includes the "reasonably anticipated" needs of the business. Section 537 of the Internal Revenue Code of 1954, 26 U.S.C.A. § 537.

The Tax Court denied any such credit on the ground that the accumulations at the end of 1954, to the extent that they reflect ownership of the farm lands, improvements thereon and equipment used thereon, are not within the reasonable needs of the business.

Petitioner's attack upon this determination is that it resulted from the erroneous placing of the burden of proof upon the petitioner.

With regard to the 1954 credit, the ultimate determination of a proscribed purpose is not involved, but only the determination of whether accumulations were retained "for the reasonable needs of the business." As to the latter, section 534 places the burden of proof squarely upon the taxing authorities. Moreover, where the ques-

tion of accumulated earnings credits are involved, the "reasonably anticipated" needs of the business, as well as its current needs, must be negatived by the Commissioner's showing.

We have already stated that under the circumstances of this case the Commissioner in effect had the burden of proof to establish that funds were accumulated beyond the reasonable needs of the business. We have also held that whether or not the Tax Court correctly understood this proposition, the unchallenged findings are supported by substantial affirmative evidence and the conclusions as to the excessive accumulation are supported by the findings. This disposes of the argument raised on the accumulated earnings credit aspect of the case, unless the fact that "reasonably anticipated" needs are to be taken into consideration makes a difference.

In our opinion it does not. In effect the Tax Court held that the accumulations for both 1953 and 1954 were beyond the reasonably anticipated needs of the business. We have already expressed the view that this holding does not evidence an erroneous understanding of the applicable statutes.

Affirmed.

(Endorsed) Opinion Filed June 28, 1961.

Frank H. Schmid, Clerk.

United States Court of Appeals
for the Ninth Circuit

Raymond I. Smith, Petitioner, vs. Commissioner of Internal Revenue, Respondent.	No. 17,015

JUDGMENT

Upon Petition to Review a Decision of The Tax Court of the United States.

This Cause came on to be heard on the Transcript of the Record from The Tax Court of the United States, and was duly submitted.

On Consideration Whereof, it is now here ordered and adjudged by this Court, that the Decision of the said Tax Court of the United States in this Cause be, and hereby is, Affirmed.

Filed and entered June 28, 1961.

Office-Supreme Court, U.S.
FILED
NOV 30 1961
JOHN F. DAVIS, CLERK

LIBRARY
SUPREME COURT U.S.

No. 524

In the Supreme Court of the United States

OCTOBER TERM, 1961

RAYMOND I. SMITH, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

ARCHIBALD COX,
Solicitor General,
LOUIS F. OBERDORFER,
Assistant Attorney General,
MELVA M. GRANEY,
MICHAEL I. SMITH,
Attorneys,
Department of Justice,
Washington 25, D.C.

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	1
Statutes involved	2
Statement	2
Argument	5
Conclusion	11
Appendix	12

CITATIONS

Cases:	
Comstock v. *Group of Investors*, 335 U.S. 211	6
Corn Products Co. v. *Commissioner*, 350 U.S. 46	6
Dixie, Inc. v. *Commissioner*, 277 F. 2d 526, certiorari denied, 364 U.S. 827	5
Helvering v. *Nat. Grocery Co.*, 304 U.S. 282, rehearing denied, 305 U.S. 669	6, 9
Helvering v. *Stock Yards Co.* 318 U.S. 693	6, 9
I. A. Dress Co. v. *Commissioner*, 273 F. 2d 543, certiorari denied, 362 U.S. 976	5
Smoot Sand & Gravel Corp. v. *Commissioner*, 274 F. 2d 495, certiorari denied, 362 U.S. 976	5
Statutes:	
Internal Revenue Code (1939)	
Sec. 102 (26 U.S.C. 1952 ed., Sec. 102)	5
Sec. 102(a) (26 U.S.C. 1952 ed., Sec. 102(a))	2, 12
Sec. 102(c) (26 U.S.C. 1952 ed., Sec. 102(c))	2, 6, 12

Statutes—Continued

Internal Revenue Code (1954):

	Page
Sec. 531 (26 U.S.C. 1958 ed., Sec. 531)	5, 13
Sec. 532(a) (26 U.S.C. 1958 ed., Sec. 532(a))	5, 13
Sec. 533(a) (26 U.S.C. 1958 ed., Sec. 533(a))	5, 6, 13
Sec. 534(a) (26 U.S.C. 1958 ed., Sec. 534(a))	5, 13
Sec. 534(b) (26 U.S.C. 1958 ed., Sec. 534b))	14
Sec. 534(c) (26 U.S.C. 1958 ed., Sec. 534(c))	14
Sec. 534(e) (26 U.S.C. 1958 ed., Sec. 534(e))	15
Sec. 535 (26 U.S.C. 1958 ed., Sec. 535)	5
Sec. 535(a) (26 U.S.C. 1958 ed., Sec. 535(a))	15
Sec. 535(c) (26 U.S.C. 1958 ed., Sec. 535(c))	15
Sec. 537 (26 U.S.C. 1958 ed., Sec. 537)	5

In the Supreme Court of the United States

OCTOBER TERM, 1961

No. 524

RAYMOND I. SMITH, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 72–97) are reported at 33 T.C. 141. The opinion of the Court of Appeals (Pet. v–xviii) is reported at 292 F. 2d 470.

JURISDICTION

The judgment of the Court of Appeals was entered on June 28, 1961. (Pet. xix.) The petition for a writ of certiorari was filed on October 30, 1961. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

QUESTION PRESENTED

Whether the court below erred in affirming the Tax Court's finding that in 1953 and 1954 the taxpayer-

corporation permitted its earnings to accumulate beyond its reasonable needs for the purpose of preventing the imposition of the surtax on its sole stockholder, and therefore was liable in those years for the surtax imposed by Section 102 of the Internal Revenue Code of 1939 and by Section 531 of the Internal Revenue Code of 1954.

STATUTES INVOLVED

Section 102 (a) and (c) of the Internal Revenue Code of 1939 and Sections 531, 532(a), 533(a), 534 (a), (b), (c) and (e), 535(a), (c)(1) and (2), and 537 of the Internal Revenue Code of 1954 are set out in the Appendix, *infra*, pp. 12–16.

STATEMENT

The taxpayer-corporation is a Nevada corporation engaged in the business of operating bars on the premises of Harold's Club (hereinafter called the Club) in Reno, Nevada. The business had been started in 1944 as a sole proprietorship by Raymond I. Smith, the father of the owners of the Club (Harold S. and Raymond A. Smith) and, when the taxpayer-corporation was formed in 1946 to take over the bars, Raymond I. Smith became its sole stockholder. He owned no interest in the Club, which was separately incorporated, but was employed as the Club's general manager at a salary of $10,000 a year plus 20 percent of the net profits before taxes and salaries. His income from the Club ranged from $44,000 in 1941 to a high of $557,559.57 in 1953. (R. 73–76; Pet. App. vi–vii.)

Since its incorporation, the taxpayer-corporation has realized net income ranging from $101,052.13 in 1947 to a high of $278,630.70 in 1955. Despite its prosperity it has never paid a salary or dividends to its sole stockholder. Consequently, by the end of 1955 it had accumulated undistributed earnings in the sum of $781,475.25. (R. 61, 76–77; Pet. App. vii.)

During the period 1950 through 1954, the top bracket personal income tax rate of Smith and his wife averaged 87 percent. (R. 77; Pet. vii–viii.)

All of the taxpayer-corporation's patrons come solely from the Club and, accordingly, its efforts to promote its business are geared to increasing the number of the Club's customers. This also benefits the taxpayer-corporation's sole stockholder personally, since his compensation as the Club's general manager is based upon its net profits. (R. 79; Pet. App. viii.)

One such promotional outlay by the taxpayer-corporation, made in 1949, was for the purchase of a gun collection and memorabilia of the Old West, which were subsequently used to advertise the Club. Other expenditures were for the purchase of a motel in 1951 and the acquisition of a coffee shop in 1953, both of which were used for the accommodation of the Club's patrons. (R. 79–81, 83–84; Pet. viii-ix.)

In December 1953, the taxpayer-corporation purchased two parcels of farm land located approximately three miles south of Reno, on the main highway from Las Vegas, Carson City and the south end of Lake Tahoe. The total cost was $870,879.55. In 1954, the taxpayer-corporation purchased an addi-

tional 2½ acres of adjoining property for $110,096.80. The farm property had originally been offered to the Club but it was not in a position to make the purchase because it was then engaged in the construction of a seven story building at its downtown Reno location. (R. 85–86; Pet. ix.)

At the time the taxpayer-corporation made these purchases, it was aware, along with the Club, that competing interests were attempting to buy the property near Reno. The owners of the Club and the taxpayer-corporation felt that the Club should be protected against such competition and that desirable land might not be available later. At the time of the purchase, however, the taxpayer-corporation had no plans for the development of the property, and both it and the Club planned to develop the land only if at some future time it became necessary. The plan contemplated a large hotel, gambling casino, convention hall, all season swimming pool, golf course and some residential property, all at an anticipated cost of $10,000,000. In 1957 the taxpayer-corporation engaged an architect who presented preliminary plans and an estimate of $17,000,000 as the probable cost of the project. No blue prints for the project were ever prepared. Since its purchase of the land, the taxpayer-corporation has been leasing it to crop farmers. (R. 86–88; Pet. ix–x.)

As to the years 1953 and 1954, the Tax Court found that the taxpayer-corporation's earnings were accumulated beyond the reasonable needs of its business for

the purpose of preventing the imposition of the surtax on its sole stockholder—a finding which makes the corporation liable in those years for the surtax imposed by Section 102 of the Internal Revenue Code of 1939 and Section 531 of the 1954 Code. (R. 93–97.) The Court of Appeals affirmed. (Pet. App. xi-xviii.)

ARGUMENT

The decision below is correct and there is no conflict of decisions or other occasion for further review of the case by this Court. Decision turns on a factual finding in which both courts below concurred. In the last two terms this Court declined to review other cases involving the same issue and basically similar factual situations. *I. A. Dress Co.* v. *Commissioner,* 273 F. 2d 543 (C.A. 2d), certiorari denied, 362 U.S. 976; *Smoot Sand & Gravel Corp.* v. *Commissioner,* 274 F. 2d 495 (C.A. 4th), certiorari denied, 362 U.S. 976; *Dixie, Inc.* v. *Commissioner,* 277 F. 2d 526 (C.A. 2d), certiorari denied, 364 U.S. 827.

1. The case involves the application of Section 102 of the Internal Revenue Code of 1939 (Appendix, *infra,* p. 12) and its successor, Sections 531 through 537 of the Internal Revenue Code of 1954 (Appendix, *infra,* pp. 13–16), which impose a surtax upon a corporate taxpayer if it is availed of for the purpose of avoiding the imposition of surtax upon its shareholders by permitting earnings to accumulate instead of distributing them to shareholders in whose hands they would be taxed as dividends received. An ac-

cumulation beyond the reasonable needs of the business is expressly made sufficient to establish liability for the corporate surtax. (Section 102(c) of the 1939 Code; Section 533(a) of the 1954 Code.) Whether an accumulation is excessive (and therefore whether the corporation was availed of for the interdicted purpose) is of course a question of fact on which the trial court's findings are conclusive if supported by the evidence. *Helvering* v. *Stock Yards Co., supra,* p. 700; *Helvering* v. *Nat. Grocery Co.,* 304 U.S. 282, 295, rehearing denied, 305 U.S. 669.

Here the Tax Court concluded that the taxpayer-corporation's earnings and profits for the years 1953 and 1954 were accumulated beyond the reasonable needs of its business (R. 97). The Court of Appeals affirmed, stating (Pet. App. xviii) that the unchallenged subsidiary findings of the Tax Court are supported by "substantial affirmative evidence" and that the Tax Court's conclusions as to the excessive accumulation of earnings "are supported by the findings."[1] Such a finding concurred in by the two lower courts is entitled to finality. *Corn Products Co.* v. *Commissioner,* 350 U.S. 46, 51; *Comstock* v. *Group of Investors,* 335 U.S. 211, 214.

[1] The Tax Court also independently found (R. 96), on other evidence, that the taxpayer-corporation was availed of for the purpose of preventing the imposition of surtax on its sole stockholder, but the Court of Appeals treated this as an "alternative ground" for decision (Pet. App. xvi) and concentrated on answering taxpayer's attacks upon the Tax Court's conclusion that the corporation had accumulated earnings beyond the reasonable needs of its business.

At any rate, this case is no exception to the general rule, since the unchallenged subsidiary findings of the Tax Court reflect a number of factors supporting a conclusion that taxpayer's earnings were accumulated beyond the reasonable needs of its business. Its business was operating bars in the Harold Club. It had accumulated earnings of almost $440,000 at the beginning of 1953, and in each of the years 1953 and 1954 it had additional income of over $220,000. (R. 76.) In December of 1953 it purchased 339 acres of farm land for over $818,000 and in 1954 purchased an additional tract for over $110,000. (R. 85.) Its bar business was merely subordinate to the operation of the Harold Club. (R. 93, 95; Pet. App. xv.) And, while it was dependent upon customers of the Harold Club for patrons of its bar business, there was no reasonable relationship between that interest in the Club's prosperity and the size and nature of the land transactions which taxpayer entered into in the taxable years. (R. 94–95; Pet. App. xv.) The farm land purchases would benefit the Club more than taxpayer. (R. 95.) Taxpayer's commitments in connection therewith were entirely out of proportion to its working assets and annual income. (Pet. App. xv.) Under the purported plan for a $10,000,000 construction project on the land, a substantial portion of the farm land acreage was to be diverted to unrelated business activities (R. 86–87, 95) and even that plan was postponed indefinitely (R. 88). Taxpayer's plans for using its

farm land acquisitions in its business were at best vague and indefinite.[2] (R. 87–88, 94; Pet. App. xv.)

2. Taxpayer's assertion that the case presents an important question which should be settled by this Court (Pet. 9–16) refers to the question of which party—the Commissioner or the taxpayer—has the burden of proving whether taxpayer's earnings were accumulated beyond the reasonable needs of its business. That question is not in issue. The Tax Court did not state which party had the burden of proof; it simply made findings, which are unchallenged, and concluded from those findings that in 1953 and 1954 taxpayer's earnings were accumulated beyond its reasonable needs. (R. 93–97.) On appeal the court below agreed with taxpayer's contention that the burden of proof was on the Commissioner (Pet. App. xii–xiii) but it rejected, after careful consideration, taxpayer's further contention that the Tax Court had placed the burden on taxpayer instead of the Commissioner and that that placement of the burden had influenced the result (Pet. App. xi–xiv, xvi–

[2] Aside from the question of excessive accumulation of earnings, the following additional evidence further indicates that taxpayer was availed of for the purpose of permitting the imposition of surtax on its sole stockholder: Subsequent to its incorporation, taxpayer never paid any dividends (R. 77); its sole stockholder was in high income tax brackets during the taxable years (R. 77); the stockholder was able to effect a tax saving of approximately $80,000 in 1953 and $100,000 in 1954 by reason of taxpayer's failure to declare dividends (R. 153); and, as a result of taxpayer's failure to ever declare a dividend, its accumulated earnings and profits increased from approximately $63,000 to approximately $640,000 in just eight years (R. 61).

xvii). Thus, the court below concluded that the Tax Court's views as to the burden of proof, "whatever those views may have been" (Pet. App. xiv), did not play any part in its conclusion that taxpayer's earnings were excessively accumulated in 1953 and 1954 (Pet. App. xiv) and that "the conclusions stated in the opinion of the Tax Court are supported by the findings of fact and give correct application to the governing statutes" (Pet. App. xvii). If these holdings are correct, as we believe, there is no necessity for this Court to review the burden of proof question or any of the other "provocative aspects" of the case (Pet. 22) suggested by taxpayer.[4]

---

[4] In relation to the burden of proof question, taxpayer also suggests (Pet. 21) that, for the benefit of the Tax Court, this Court should clarify its prior decisions in *Helvering* v. *Stock Yards Co.*, 318 U.S. 693, and *Helvering* v. *Nat. Grocery Co.*, 304 U.S. 282. This, however, is but another way of requesting review on the burden of proof question, for the 1954-1955 amendments which the court below considered and held to shift the burden of proof to the Commissioner (Pet. App. xii–xiii, xvi) had not been enacted when those cases were decided.

Taxpayer also asserts (Pet. 16–19) that the court below sanctioned improper procedure on the part of the Tax Court and was also itself guilty of improper procedure in failing to remand the case to the Tax Court with instructions for reconsideration in the light of its holding that the Commissioner had the burden of proof. The first argument assumes (Pet. 16), contrary to fact, that the Tax Court tried the case as if the burden of proof were not on the Commissioner. The other argument (Pet. 17–19) amounts only to an attack upon the correctness of the holding below that the Tax Court's findings support its conclusion that taxpayer's earnings were accumulated beyond the reasonable needs of its business.

3. Taxpayer's claims of conflict between the circuits (Pet. 19–21) are frivolous. Even if it were material, there is no indication that the court below departed from the accepted postulate that a factual question is presented in the application of the statutes imposing the accumulated earnings surtax. While the court below stated that there was presented for decision "the resolution of mixed questions of fact and law" (Pet. App. xiv), that statement implies no more than that there is always present, even in basically "factual" issues, the question whether the trier of fact has applied the proper legal standard to the facts.

The alleged conflict as to the "effect" of certain facts (Pet. 20–21) is based upon two erroneous assumptions—first, that the Tax Court gave "controlling weight to the circumstance that more taxes would have been paid by its shareholder had petitioner paid dividends" (Pet. 21) and, second, that there are no other facts to support the factual conclusion concurred in by both courts below. Since the premise that there are no other facts to support the finding is, as we have shown, unsound, the claim of conflict based on that premise is equally unsound.

CONCLUSION

The decision below is correct and no conflict of decisions or important question is presented. The petition for a writ of certiorari should be denied.

Respectfully submitted,

ARCHIBALD COX,
Solicitor General.
LOUIS F. OBERDORFER,
Assistant Attorney General.
MELVA M. GRANEY,
MICHAEL I. SMITH,
Attorneys.

NOVEMBER 1961.

APPENDIX

Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.)

SEC. 102. SURTAX ON CORPORATIONS IMPROPERLY ACCUMULATING SURPLUS.

(a) [As amended by Sec. 103(d), Revenue Act of 1941, c. 412, 55 Stat. 687] *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year (in addition to other taxes imposed by this chapter) upon the net income of every corporation (other than a personal holding company as defined in section 501 or a foreign personal holding company as defined in Supplement P) if such corporation, however created or organized, is formed or availed of for the purpose of preventing the imposition of the surtax upon its shareholders or the shareholders of any other corporation, through the medium of permitting earnings or profits to accumulate instead of being divided or distributed, a surtax equal to the sum of the following:

27½ per centum of the amount of the undistributed section 102 net income not in excess of $100,000, plus

38½ per centum of the undistributed section 102 net income in excess of $100,000.

* * * * *

(c) *Evidence Determinative of Purpose.*—The fact that the earnings or profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid surtax upon shareholders unless the corporation by the clear preponderance of the evidence shall prove to the contrary.

* * * * *

Internal Revenue Code of 1954 (26 U.S.C., 1958 ed.)

SEC. 531. IMPOSITION OF ACCUMULATED EARNINGS TAX.

In addition to other taxes imposed by this chapter, there is hereby imposed for each taxable year on the accumulated taxable income (as defined in section 535) of every corporation described in section 532, an accumulated earnings tax equal to the sum of—

(1) 27½ percent of the accumulated taxable income not in excess of $100,000, plus

(2) 38½ percent of the accumulated taxable income in excess of $100,000.

SEC. 532. CORPORATIONS SUBJECT TO ACCUMULATED EARNINGS TAX.

(a) *General Rule.*—The accumulated earnings tax imposed by section 531 shall apply to every corporation (other than those described in subsection (b)) formed or availed of for the purpose of avoiding the income tax with respect to its shareholders or the shareholders of any other corporation, by permitting earnings and profits to accumulate instead of being divided or distributed.

* * * * *

SEC. 533. EVIDENCE OF PURPOSE TO AVOID INCOME TAX.

(a) *Unreasonable Accumulation Determinative of Purpose.*—For purposes of section 532, the fact that the earnings and profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid the income tax with respect to shareholders, unless the corporation by the preponderance of the evidence shall prove to the contrary.

* * * * *

SEC. 534. BURDEN OF PROOF.

(a) *General Rule.*—In any proceeding before the Tax Court involving a notice of deficiency based in whole or in part on the allega-

tion that all or any part of the earnings and profits have been permitted to accumulate beyond the reasonable needs of the business, the burden of proof with respect to such allegation shall—

(1) if notification has not been sent in accordance with subsection (b), be on the Secretary or his delegate, or

(2) if the taxpayer has submitted the statement described in subsection (c), be on the Secretary or his delegate with respect to the grounds set forth in such statement in accordance with the provisions of such subsection.

(b) [As amended by Sec. 5 of the Act of August 11, 1955, c. 805, 69 Stat. 689] *Notification by Secretary.*—Before mailing the notice of deficiency referred to in subsection (a), the Secretary or his delegate may send by registered mail a notification informing the taxpayer that the proposed notice of deficiency includes an amount with respect to the accumulated earnings tax imposed by section 531. In the case of a notice of deficiency to which subsection (c)(2) applies and which is mailed on or before the 30th day after the date of the enactment of this sentence, the notification referred to in the preceding sentence may be mailed at any time on or before such 30th day.

(c) *Statement by Taxpayer.*—Within such time (but not less than 30 days) after the mailing of the notification described in subsection (b) as the Secretary or his delegate may prescribe by regulations, the taxpayer may submit a statement of the grounds (together with facts sufficient to show the basis thereof) on which the taxpayer relies to establish that all or any part of the earnings and profits have not been permitted to accumulate beyond the reasonable needs of the business.

* * * * *

(c) [As amended by Sec. 4 of the Act of August 11, 1955, *supra*] *Application of Section.*—

(1) Notwithstanding any other provision of law, this section shall apply with respect to taxable years to which this subchapter applies and (except as provided in paragraph (2)) to taxable years to which the corresponding provisions of prior revenue laws apply.

(2) In the case of a notice of deficiency for a taxable year to which this subchapter does not apply, this section shall apply only in the case of proceedings tried on the merits after the date of the enactment of this paragraph.

SEC. 535. ACCUMULATED TAXABLE INCOME.

(a) *Definition.*—For purposes of this subtitle, the term "accumulated taxable income" means the taxable income, adjusted in the manner provided in subsection (b), minus the sum of the dividends paid deduction (as defined in section 561) and the accumulated earnings credit (as defined in subsection (c)).

* * * * *

(c) *Accumulated Earnings Credit.*—

(1) *General rule.*—For purposes of subsection (a), in the case of a corporation other than a mere holding or investment company the accumulated earnings credit is (A) an amount equal to such part of the earnings and profits for the taxable year as are retained for the reasonable needs of the business, minus (B) the deduction allowed by subsection (b)(6). For purposes of this paragraph, the amount of the earnings and profits for the taxable year which are retained is the amount by which the earnings and profits for the taxable year exceed the dividends paid deduction (as defined in section 561) for such year.

(2) *Minimum credit.*—The credit allowable under paragraph (1) shall in no case be less

than the amount by which $60,000 exceeds the accumulated earnings and profits of the corporation at the close of the preceding taxable year.

* * * * *

SEC. 537. REASONABLE NEEDS OF THE BUSINESS.

For purposes of this part, the term "reasonable needs of the business" includes the reasonably anticipated needs of the business.

U.S. GOVERNMENT PRINTING OFFICE: 1981